



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MAURINE M. MALAN)

For Appellant: Donald Earl Ruth
Enrolled Agent

For Respondent: Elleene A. Kirkland
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of **Maurine M. Malan** against a proposed assessment of additional personal income tax in the amount of **\$1,836.82** for the year 1978.

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The sole issue raised by this appeal concerns the deductibility of legal expenses incurred in connection with a civil action associated with a divorce proceeding.

Appellant and George L. Malan (hereinafter "George") were married in 1950. In 1957, appellant, George and George's children by a previous marriage entered into an agreement which purported to characterize the parties' rights in certain patents developed by George. The purpose of the agreement was to resolve any claims or interests of the parties which might affect the title or ownership of said patents. The major elements of such understandings were the marital characterization of such property and its disposition upon the death of each party.

In September of 1975, appellant filed for dissolution of her marriage. Thereafter, in October of 1976, George and his children filed a civil action (hereinafter "civil action") against appellant which sought to enforce the above-noted agreement. The civil action was ultimately consolidated with the dissolution proceeding and, on June 27, 1978, pursuant to a stipulation, judgment was entered which divided the marital property (including the patent rights) of appellant and George.

In her California personal income tax return for 1978, appellant deducted \$25,051 in legal fees. In reply to inquiries by respondent, appellant stated that these fees were incurred in the civil action brought by George and his children and were expended in order to protect appellant's "income derived from income producing assets." This appeal was taken from respondent's disallowance of that entire deduction.

In the case of an individual, section 17252 of the Revenue and Taxation Code provides, in relevant part, for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year:

(a) For the production or collection of income;

(b) For the management, conservation, or maintenance of property held for the production of income . . .

On the other hand, section 17282 of the Revenue and Taxation Code states generally that "no deduction shall be allowed for personal, living, or family expenses."

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Respondent contends that the subject legal expenses incurred by appellant are of a personal nature being connected with her divorce and are, therefore, nondeductible. Respondent further contends that appellant has failed to substantiate the allocation between fees expended for the civil action and those expended for the dissolution proceedings.

It is not clear which subdivision of section 17252 cited above appellant relies on to justify the deductibility of the legal fees in question. Appellant simply argues that one-half of the legal expenses which she incurred and paid in 1978 is deductible under these provisions, since that part of her attorney's fees was attributable to the time spent defending the civil action to preserve her interest in the subject patent rights. We will, therefo're, consider each subdivision separately.

Subdivision (a) provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year for the "production or collection of income." Appellant apparently contends that her defense of the civil action was related to preserving her right to receive royalty payments for the use of the patents for the rest of her life. Appellant argues that the holding of William A. Falls, 7 T.C. 66 (1946), supports the deductibility of the subject legal fees. In Falls, the taxpayer was named as a defendant in a suit to recover possession of patents, allegedly obtained by him by fraud, and to recover the royalties which the taxpayer had been receiving from the licensee. The taxpayer was successful in resisting the suit and sought to deduct his legal fees and expenses. The tax court held that he could, in fact, deduct the portion of such expenses that was attributable to the value of past (as opposed to future) royalty income he was defending. In the instant case, the record does not indicate that any of the subject legal fees was attributable to such past royalty income. It is well settled that the burden of proof is upon the taxpayer to establish his entitlement to a deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 13481 (1934)]; Appeal of Robert V. Erilane, Cal. St. Bd. of Equal., Nov. 12, 1974.) Accordingly, we hold that the Falls case is not in point here. Moreover, we note that the Falls rationale has not received universal favor. (See Munson v. McGinnes, 283 F.2d 333 (3d Cir.), cert. den., 364 U.S. 880 [5 L.Ed.2d 103] (1960).) Therefore, we must conclude that the expenses are not deductible under subdivision (a) of section 17252.

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Next, we consider subdivision (b), which provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year for the "management, conservation, or maintenance of property held for the production of income." The United States Supreme Court has dealt with this precise issue when it arose under similar provisions of the Internal Revenue Code. In United States v. Gilmore, 372 U.S. 39 [9 L.Ed.2d 5701 (1963)], the Supreme Court held that legal fees incurred by the husband in divorce proceedings while resisting his wife's claim that certain of his assets constituted community property, were nondeductible personal expenses. In reaching that decision the Court stated:

. . . the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was "business" or "personal" and hence whether it is deductible or not (372 U.S. at 49.)

In a second decision rendered the same day, United States v. Patrick, 372 U.S. 53 [9 L.Ed.2d 5801 (1963)], the Supreme Court again applied this test and determined that legal fees paid by the husband for services rendered in connection with a property settlement agreement were nondeductible personal expenses, having arisen out of the taxpayer's marital relationship rather than from his profit-seeking activities. Moreover, this board has consistently followed these Supreme Court decisions. (Appeal of George E. Newton, Cal. St. Bd. of Equal., May 12, 1964; Appeal of Reuben Merliss, Cal. St. Bd. of Equal., June 28, 1966; Appeal of Joseph H. Babros, Cal. St. Bd. of Equal., Feb. 18, 1970; Appeal of Curtis Lee, Cal. St. Bd. of Equal., July 26, 1978.) --

Applying the test stated in the Gilmore and Patrick decisions to the instant facts, it is clear that the claims involved in the civil action arose out of the marital relationship. Indeed, the record indicates that the civil action was ultimately consolidated with the dissolution proceeding and a judgment was entered which divided the marital property, including the patent rights which were the subject of the above-noted agreement. The legal expenses in question here were incurred in connection with that claim. Accordingly, we conclude that those expenses were of a personal nature, and were not deductible under section 17252, subdivision (b), of the Revenue and Taxation Code. Because of this conclusion, it is unnecessary to discuss the issue of the propriety of appellant's allocation of legal fees between the civil action and the divorce proceeding.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Maurine M. Malan against a proposed assessment of additional personal income tax in the amount of \$1,836.82 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett, _____ Chairman
Conway H. Collis _____, Member
Ernest J. Dronenburg, Jr. _____, Member
Richard Nevins _____, Member
Walter Harvey* _____, Member

*For Kenneth Cory, per Government Code section 7.9